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JAN 29 1997

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Transport Rate Structure and Pricing	)	CC Docket No. 91-213
	)	
Usage of the Public Switched Network by Information Service and Internet Access Providers	)	CC Docket No. 96-263

COMMENTS OF U S WEST, INC.

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SUMMARY

In these Comments, U S WEST presents a series of proposals that will enable a rational transition of access services to the new competitive environment. Unfortunately, the existing regulatory landscape injects serious risk into the process of implementing the 1996 Act's mandate of telecommunications competition. Unless the Commission addresses all the risk factors with an integrated plan, it will seriously damage -- and perhaps destroy -- some industry participants and telecommunications infrastructure.

Our Comments begin by describing the existing situation and the perils it poses to both the Commission and the state commissions. We explain the Commission's absolute Constitutional obligation to give the incumbent local exchange carriers ("ILEC") an opportunity -- not a guarantee -- to earn on their investment in telecommunications facilities and ultimately to recover that investment. That obligation will remain until the regulatory commissions no longer control the ILECs' rates.

The ILECs' ability to earn a reasonable return on their investment in today's subsidy-riddled regulatory structure has been seriously eroded by TELRIC pricing, particularly as it is being implemented by the states. Given the availability of unbundled network elements priced at some notion of forward-looking cost, the regulatory system can no longer carry the massive subsidies the regulators have loaded into it over the years.

We discuss the uneconomic distortions inserted into access prices by the jurisdictional separations process. The uneconomic "costs" -- implicit subsidies --

loaded onto interstate services are no longer sustainable, as virtually all members of the industry recognize. Yet, the Commission may not -- consistent with its Constitutional obligations to the ILECs -- simply ignore these costs or assume they will just "go away." The necessary movement of access prices in the direction of economic costs can only take place in conjunction with a major overhaul of all rates -- both interstate and intrastate -- to eliminate anticompetitive implicit subsidies. This necessary reform must include elimination of the ILECs' depreciation reserve deficiency, separations reform, and federal and state rate rebalancing. The concept of prices based on "economic cost" can have no meaning within the context of today's regulatory structure. So long as the subsidy structure remains in place, the Commission must maintain mechanisms to permit full cost recovery of subsidized and subsidizing services.

In this proceeding, the Commission proposes two approaches to access reform, a prescriptive approach and a "market-based" approach. We explain that the prescriptive approach is simply a continuation of existing regulation, with the added feature of a steady, programmed decline in the ILECs' access revenues.

The market-based approach, though clearly preferable to the prescriptive approach, falls far short of its potential. Though it provides the ILECs some needed flexibility in their pricing, the market-based approach, as described in the Notice of Proposed Rulemaking, provides too little relief, and it does so far too late. Indeed, under the proposal, the ILECs would not get to regulatory forbearance, which we believe the 1996 Act intends. We will explain the appropriate criteria the Commission should apply in determining that an ILEC is entitled to regulatory freedoms, and we will discuss the additional reforms -- culminating in non-dominant regulatory treatment -- the market-based approach should include. We note that the Commission should consider streamlined procedures to resolve petitions for forbearance, so that the ILECs are not needlessly tied up in regulatory proceedings when they face actual competition.

We comment on the Commission's proposals to restructure access charges, and put forward a number of suggestions to revise those proposals. We note the pressing need to move subsidy elements in the carrier common line charge and transport interconnection charge to a flat-rated recovery mechanism.

The transition to full competition will require the careful balancing of opposing considerations. The Commission must give the ILECs an opportunity to continue to earn on their investment and to recover that investment. But it must accomplish this in a way that does not preclude the new competitive entrants from the market. We explain why the Commission can accommodate these conflicting considerations only by means of a bulk-billed charge on the interexchange carriers.

Finally, we discuss the continued need to do away with the enhanced service provider exemption from the payment of access charges. The economic dislocations brought about by this exemption are simply intolerable in a competitive environment.

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COMMENTS OF U S WEST, INC.

U S WEST, Inc. ("U S WEST") hereby submits its comments in the above-captioned proceeding.[1]

I. INTRODUCTION

In the Notice, the Federal Communications Commission ("Commission") seeks comment on how to modernize its access charge rules in order to make them more compatible with the realities of the modern marketplace as it exists (and will exist) under the Telecommunications Act of 1996.[2] The Notice clearly contemplates that microregulation of interstate access charges will be unnecessary as the market

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[1] In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, Usage of the Public Switched Network by Information Service and Internet Access Providers, CC Docket Nos. 96-262, 94-1, 91-213 and 96-263, Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry, FCC 96-488, rel. Dec. 24, 1996 ("Notice").

moves closer to full competition, and that competition will drive interstate access prices closer to economic costs no matter what regulatory structure is in place. This fundamental premise is true -- artificial regulatory prices and subsidies are simply not sustainable in a competitive marketplace. Accordingly, the goals of the Notice are accurate and well considered.

In managing the transition to a competitive market, the Commission must keep in mind several critical principles which must guide the essential Commission response to the 1996 Act -- or risk both countervening the pro-competitive thrust of the 1996 Act and subverting the nation's telecommunications infrastructure. This is not to say that the Commission would ever deliberately take actions designed to achieve either of these detrimental impacts, but the forces now driving the telecommunications market are so delicate and volatile that the potential for inadvertent mischief is great, and some powerful players are insisting that the Commission take steps which would create precisely this result. The Commission must also resist the demand from some quarters to microregulate where less, not more, regulation is necessary. In this introduction, we set forth several key principles which must guide this proceeding.

A. Full Capital Recovery For Incumbent Local Exchange Carriers ("ILEC") Is Critical And A Matter Of Constitutional Necessity (¶¶ 241-269)

In a variety of regulatory proceedings, before this Commission and other regulatory bodies, U S WEST routinely sees discussions of what are called prices

[2] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) ("1996 Act").

based on "economic costs," the forward-looking costs in the direction of which competition drives the prices of competitors. The Commission, in its Interconnection docket,[3] devised a fairly sophisticated version of long run incremental costs which it called TELRIC, or Total Element Long Run Incremental Costs. The notion seems to be that, as competitive markets tend to drive prices in the direction of TELRIC, a sensible regulatory system can promote competition by establishing prices at the level of TELRIC immediately.

In theory, a TELRIC-based universe looks appealing, and giant competitors such as AT&T Corp. ("AT&T") and MCI Telecommunications Corporation ("MCI") are advocating such a costing/pricing scheme (for their competitors, of course, not for themselves). But even assuming that TELRIC represents a properly calculated forward looking or "economic" cost, implementation of TELRIC as a pricing mechanism, especially on a piecemeal basis, is not justifiable on a legal or economic basis. In fact, in the real world, prices are never actually set at TELRIC because investment in new technology cannot be sustained if a TELRIC-based costing methodology were used to set price ceilings. Moreover, immediate application of TELRIC (or any other forward looking cost methodology) as a methodology for setting prices without simultaneously fixing several other critical parts of the regulatory landscape would be unwise and illegal. Thus, one of the essential

[3] In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers, CC Docket Nos. 96-98 and 95-185, First Report and Order, FCC 96-325, rel. Aug. 8, 1996 ("Interconnection Order"), appeals pending sub nom. Iowa Utilities Board v. FCC, Nos. 96-3321, et al. (8th Circuit).

premises of the Notice is potentially flawed. In the following sections we detail several critical aspects of implementation of the 1996 Act which must be recognized in this access reform docket.

1. Full ILEC Capital Recovery Is Essential

The first concept which must guide the Commission is that it may not take regulatory action in this docket which operates to deprive ILECs of the opportunity to recover their investment -- or to recover their ongoing costs of doing business.[4] U S WEST submits that the Constitution requires that the Commission not take action which would make it impossible, for regulatory reasons, for U S WEST to recover the full amount of its prudently made investment and its actual operating costs.

In this regard, it must be remembered that U S WEST's costs of doing business are in no respect unreasonable. Indeed, in a formal complaint at the Commission, MCI is contending that U S WEST's costs of providing local access service are too low, not too high.[5] If, in fact, some rates are in excess of the costs of providing the service in question (e.g., if the Competition Telecommunications Association ("CompTel") were to be correct in its allegation in the Eighth Circuit that interstate switched access is priced at seven times its cost),[6] it is not because

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[4] U S WEST also submits that it has the absolute right to recover all costs incurred pursuant to regulatory mandate.

[5] See MCI Telecommunications Corp., et al. V. U S WEST Communications, Inc., et al., E-96-7, Notice of Formal Complaint, dated Jan. 11, 1996.

[6] See Iowa Utilities Board v. FCC, Nos. 96-3321, et al., Brief of Petitioner CompTel at 5 (8th Cir. Nov. 18, 1996).

U S WEST is providing the service in an inefficient manner or is earning supercompetitive profits.

If interstate access is priced above cost, the reason for such pricing lies heavily in regulatory decisions requiring that other services be priced below cost. Any effort to lower the price of any service via a regulatory proceeding on the basis that the service is priced above cost must be accompanied by action which permits the raising of the appropriate prices of other services previously subsidized by the above-cost rate, or by other remedial action pursuant to the 1996 Act's universal service mandate.

We also hear much comment these days to the effect that the property and revenues of U S WEST are "ratepayer" property, as if U S WEST's property is accordingly subject to reduced Constitutional protection against governmental seizure and/or manipulation because it has been utilized over the past decades to provide common carrier services on a regulated basis. Such statements and implications are grossly erroneous and in direct contradiction to the actual state of the law and the Constitution. U S WEST's property is its own private property and is subject to the same Constitutional protections as is the property of any other corporate citizen.[7] No matter how noble the intentions of government, the private property of U S WEST belongs to U S WEST, not to the public, the federal government, or an amorphous group of "ratepayers."

[7] See Northern Pacific R.R. v. North Dakota, 236 U.S. 585, 595 (1915).

We have also heard much recently to the effect that now that competition has entered the telecommunications marketplace, ILECs can no longer expect the Government to guarantee them the ability to earn a profit on their operations. The implication here is that the regulatory compact whereby telephone companies were entitled to a fair rate of return on their total investment as a matter of law is no longer operative, because competitive businesses all must face the risk of loss whenever they conduct business operations. This argument misses the point of the right of regulated companies to the opportunity to earn a reasonable rate or return so long as they are regulated.

To be sure, if the Commission and state regulatory commissions were to simply turn local exchange carrier ("LEC") pricing over to the marketplace, a different analysis would be necessary. The federal government does not normally owe to any company the ability to operate profitably. On the contrary, so long as the Government stays out of the way of an American business, the right and ability to lose money is a fundamental premise in a capitalist economy.

But U S WEST has seen very little indication that government at any level is poised to permit U S WEST and other ILECs to operate their businesses totally as they see fit. Instead, U S WEST's interstate rates (for interconnection, network elements, and interstate access) are pervasively regulated by this Commission. Its intrastate rates are likewise subject to intensive regulation by state regulatory authorities, and the instant Notice is, in many key respects, characterized by more, not less, regulation. Under the circumstances where the prices for U S WEST's services are to a large extent set by the government, the government has an obligation to set those prices so that U S WEST can operate profitably. In the context of Commission and state proceedings affecting price, mandated price changes in one area must be accompanied by offsetting price changes in other areas.

This basic proposition is really self-evident. The government (federal, state, or combined) cannot force U S WEST to conduct business at a loss. Unless the government (in this case this Commission) is willing to deregulate U S WEST's prices, it must stand as the guarantor that the prices the government sets (or limits) are at a level which ensures the financial viability of the U S WEST enterprise as a whole.[8]

The prices must also be set so that each prescribed price is profitable, at least within the context of the family of services and functions whose prices are being simultaneously established.[9] What a regulatory authority cannot do lawfully is to remain involved in price setting, but decline to stand behind the overall profitability of the enterprise whose prices were established, on the theory that competitive market forces eliminate the need for ensured profitability.

Furthermore, in the context of the 1996 Act, it is expected by the Commission (and by state regulatory agencies) that ILECs will often be required to engage in facilities construction which is contrary to their business judgment. The Commission's Interconnection Order is replete with mandatory construction obligations, including the obligation to construct facilities for competitive carriers

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[8] Duquesne Light Co. v. Barasch, 488 U.S. 299, 307-08 (1989).

[9] FPC v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944).

superior to what U S WEST would construct for its own use.[10] State and federal "carrier-of-last resort" obligations generally remain on the books in the case of ILECs, and ILECs are generally perceived as having the responsibility to provide service (at regulated service quality levels) to all comers,[11] regardless of the prudence of the investment decision.

As noted below, the Commission is tasked with eliminating all implicit subsidies. But beyond general considerations of non-confiscatory rate levels for the provision of telephone service, the new marketplace now places a very heavy burden on a governmental entity seeking to coerce a company to construct facilities against its will. In such cases, the governmental structure must be such as to ensure that payment for such construction is complete, certain and timely. The government cannot force a company to construct facilities against its will unless there is available a specific payment mechanism to cover the cost of the coerced construction.[12] Otherwise the order directing construction is itself invalid and unenforceable. This basic notion is essential in this proceeding, in which it is contemplated that carriers (especially ILECs) will be expected to make uneconomic

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[10] See U S WEST's May 16, 1996 Comments, CC Docket No. 96-98 at 32-35 ("U S WEST's May 16, 1996 Interconnection Comments").

[11] See generally Southwestern Bell Telephone Company, et al., Applications for Authority Pursuant to Section 214 of the Communications Act of 1934 to Cease Providing Dark Fiber Service, Memorandum Opinion and Order, 8 FCC Rcd. 2589 (1993), rev'd on other grounds, Southwestern Bell Telephone Co., et al. v. FCC, 19 F.3d 1475 (D.C. Cir. 1994).

[12] U S WEST's May 16, 1996 Interconnection Comments at 35.

investments and provide below-cost service in the expectation that they will be made whole for their construction via the mechanisms established herein.

In the newly emerging competitive marketplace, any government mandate that a particular service or facility be priced below cost in order to subsidize the services of others (or to achieve another public interest purpose) would constitute a partial governmental seizure of that facility. For example, if a loop is mandated to be offered at a price of $20.00, while the cost of that loop is $40.00 (both per month), the mandating governmental agency has effectively seized that loop and required that it be dedicated to a public purpose.

Compensation is due to the provisioning company for the difference. While the vehicle for providing this compensation in some instances is the subject of the instant proceeding, the fundamental legal principle that governmental seizure of LEC plant results when that plant is required to be dedicated to the public purpose of providing subsidized service is key to understanding how regulators must deal lawfully with all subsidies, not just those within the ambit of this docket.

Obviously the extent to which the Commission must actually take action driving an ILEC into bankruptcy before an actual confiscation of the ILEC's property is a matter which will ultimately be decided by the courts -- U S WEST contends that the Constitution protects its property with considerably more vigilance than a guaranty against government coerced bankruptcy. In fact, we submit that, in the emerging competitive marketplace, U S WEST is Constitutionally entitled to the opportunity to make a reasonable profit on all of its lines of business -- including capital recovery of actual investment and sufficient margin to permit economic investment and risk-taking and competitive depreciation lives (that is, lives which are similar to those of U S WEST's competitors). However the scope of U S WEST's Constitutional rights are ultimately defined, it is clear that any regulatory structure which prevents meaningful cost recovery would not be lawful or reasonable. Several permutations of this matter are discussed herein.

2. All Implicit Subsidies Must Be Eliminated

The first, and potentially most intractable, matter standing in the way of reasonable ILEC cost recovery is the massive system of subsidies which permeate ILEC rate structures. The 1996 Act requires that these subsidies -- all of them -- be eliminated and replaced via properly established competitively neutral universal service fund mechanisms.[13] While the Notice clearly recognizes the necessity of eliminating subsidies as a theoretical matter,[14] it really fails, as have the earlier orders on interconnection and universal service, to address most of the key subsidy areas which hover ominously over access reform and full realization of Congress' vision of a truly competitive marketplace.

The reasons for most of these subsidies are political, and the Notice does not give sufficient recognition to the fact that much of the current structure of access (and other LEC telecommunications prices) are based on political, not economic, concerns. The political foundation of much of the access charge structure might (indeed probably will) make the problems of a rational solution to access charge reform far more intractable than would be the case if the problems were all a simple

[13] 47 USC § 254(k).

matter of economics. In devising access charge solutions in the context of the overall telecommunications market structure, the Commission must not duck the difficult political questions just because they are political in nature. The fact that the issues are political gives this Commission, which tends to be less political than state commissions, a special responsibility to ensure that proper differentiation between the political and economic impetus for existing rules and regulations is maintained. As is discussed below, the essential interrelationships between all aspects of telecommunications reform (intrastate as well as interstate) make the Commission's duty to make the difficult political decisions critical.

There are a number of aspects of telecommunications pricing which have their origins in politics, not economics. For example:

- The bulk of the carrier common line (or "CCL") charge is a pure implicit subsidy based on the unwillingness of the Commission to tie interstate residential loop prices to the separated interstate costs assigned to those loops. The Commission does propose to treat this subsidy, but not by assigning the same subscriber line charge ("SLC") rate to residential loops as it does to business loops.[15]

- Separations itself has, at least since the 1960s, been a subsidizing device to keep intrastate local rates low. As is discussed below, separations reform will mean facing the tough decisions that will come with the necessary increases in local rates attendant to such reform.

- The enhanced service provider ("ESP") exemption, addressed in the Notice primarily via a Notice of Inquiry, is almost entirely political in nature. Despite ESP protestations that they really do not use the network in the same manner as do interexchange carriers (or

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[14] Notice ¶ 8.

[15] In fact, the Commission proposes to compound the misassignment of loop costs by proposing, in this Notice, an increase for multi-line businesses.

"IXC"), the issue is really one of jurisdictional assignments, not network usage. In essence, interstate ESPs use local exchange switching facilities for the origination and termination of interstate communications, and do not pay for the interstate portion of those facilities.

- For many years regulators have kept local rates low by assigning overlong lives to LEC equipment for depreciation purposes. While this problem is most acute at the state level, even the Commission has declined to permit LECs to use the same lives for depreciation purposes as other competitors do. Underdepreciation based on uneconomic depreciation lives creates a substantial subsidy to certain ratepayers. This subsidy, as it both suppresses competition (by maintaining below-cost rates which are difficult for competitors to undercut) and investment (by making it necessary to keep obsolete investment in service because it has not been depreciated), is clearly contrary to the goals of the 1996 Act. It will no doubt be difficult to alter because of its political origins.

Of course, the most critical subsidies generally lie outside the direct jurisdiction of this Commission. State regulatory regimes are often marked by huge subsidy structures designed to keep local residential rates at below cost levels. The most obvious examples of such subsidies are the business/residence dichotomy, the toll/local rate dichotomy, and the subsidization of local basic rates by vertical features.[16] Below cost residential pricing has intense political support. In the long run, the success of any Commission effort (or the effort of any other entity) to aid in the development of true competition in local markets will no doubt depend on the ability to rationalize pricing in the local intrastate markets.

We submit that the Commission must, as a legal imperative, review access reform in the context of this subsidy-riddled structure. It may not act in a manner

[16] Attached hereto as Exhibit 1 is an Affidavit by Robert G. Harris and Dennis A., submitted with U S WEST's May 16, 1996 Interconnection Comments. Harris and Yao discuss these subsidies in sections C2, C4, C5 andC6.

which might make sense in a vacuum (or which might make sense if access reform were the only relevant docket) but which, in the context of the larger telecommunications picture, fails to treat the entire problem.

3. TELRIC Pricing Demonstrates The Extent Of The Subsidies Which Must Be Eliminated

The Commission proposes in the Notice to move access charges to economic costs, generally viewed by the Commission as TELRIC. AT&T and MCI are relentless in demanding that a truly confiscatory pricing structure be put in place using the Commission's rubric of prices based on "economic costs." Assuming that setting economic TELRIC-based costs as a price ceiling is a good idea, and that TELRIC is an accurate measure of economic costs, a fairly simple TELRIC analysis shows precisely where the danger in piecemeal cost/price analyses lies. Stated simply, if all U S WEST existing regulated services were priced at TELRIC (a TELRIC which uses competitive depreciation lives which state regulators have thus far refused to recognize), and accommodation were made for the reserve deficiency which regulators have required that U S WEST create, the result would not be disastrous, or at least not immediately so. However, if only access, interconnection and related services are priced according to TELRIC principles, while local residential service remains priced as it is today, the results can be truly catastrophic -- for ILECs, for competition and for the nation's telecommunications infrastructure. A simple analysis demonstrates the extent of the danger.

The following chart shows a comparison between existing (1995) revenue and TELRIC costs for the majority of U S WEST's regulated services.[17]

U S WEST**

Category	Current Annual Revenue	TELRIC Unbundled Annual Revenue
Local Exchange	$ 3,225,150,200	$ 5,971,237,201
EUCL	$ 724,154,270	
Features/Port	$ 653,328,372	$ 262,913,094
Toll	$ 930,919,355	$ 43,060,687
Switched Access		
Interstate	$ 1,318,378,197	$ 121,316,448
Intrastate	$ 474,917,504	$ 38,310,522
Sub Total	$ 7,326,847,898	$ 6,436,838,160
Percent Current Revenues		88%

**[18]

[17] Private line, special access non-recurring independent company toll, other and miscellaneous revenues are not counted because of calculation uncertainties.

**[18] The following assumptions were used in these calculations:

Local Calculations

LIS Link - State specific TELRIC rates have been used
Port A - State specific TELRIC rates have been used
Local Switching - State specific TELRIC rates have been used

Intraoffice Switching - Assumes 20% of the Originating Local Exchange traffic is Intraoffice calling and is using only one switch element.

Interoffice Switching - For the remaining 80% Interoffice calls these units use two switch elements - Outgoing on the Originating switch and incoming on the terminating switch

Tandem Switch on Local - is assumed to be in the 15% range and is taken only against the originating interoffice calls described in the previous paragraph

In other words, TELRIC costing applied to these limited services demonstrates a significant revenue shortfall, to some extent caused by the depreciation revenue deficiency.[19] But most significantly, these analysis documents a $2 billion annual subsidy by local exchange rates -- a subsidy which would be considerably higher if only residential rates were considered.

What is the lesson here? It is simple. The Commission cannot move toward pricing of access based on any configuration of economic costs without a simultaneous rebalancing of all rates. Adopting TELRIC in a vacuum is simply not a lawful option.

Switched Transport on Local - in these calculations the transport is assumed to be directed trunked 85% if tandem routing is assumed to 15%. The direct trunked routes use one transport element and the tandem routed uses 2 elements.

Local Usage Profiles - Subscriber Line Usage studies are used to evaluate the total local and service specific implications of rate changes. These numbers represent the monthly originating local MOU s per line

IntraLATA Toll Calculations: These calculations assume two things:

1. All toll is interoffice in nature
2. All toll is Tandem routed
3. 2 End office switch and switched transport are needed
4. 1 tandem element is used

Interstate and Intrastate Switched Access Ä These calculations assume:

1. Only one end office switch and switched transport elements are used for Direct routed transport
2. A Tandem is used for 25.S% of calls Ä on these calls I EO and tandem switch is used with two switched transport elements

Features

1. Central Office Feature costs have not been included Ä the revenue offset in the display is the TELRIC associated with the port average. Sl.55 for USWC.

[19] Because of state regulators' refusal to recognize the importance of economic depreciation lives, states have derived TELRIC costs considerably below these costs. These calculations are based on proper calculation of TELRIC as set forth in the Interconnection Order, including proper depreciation lines.

4. Separations Reform Is Critical

As a practical matter, there is a fundamental disconnect between what the Commission views as prices based on economic costing -- i.e., some variant of TELRIC -- and the separations process. The separations process loads costs into the interstate jurisdiction in a manner which bears little resemblance to how the costs were incurred. Yet the Commission today looks at these separated costs as indicating whether services were properly priced, and whether the carrier should be sharing some of the profits from its interstate services. Thus, the costs against which interstate services are measured will necessarily bear little relationship to TELRIC, no matter how well the services were priced in the first place. A situation which would include prices set at TELRIC levels and profits measured at separated historical cost levels, is simply not a rational one.

U S WEST has recently experienced a very strange manifestation of just this phenomenon. U S WEST offers frame relay service pursuant to interstate tariff. The service is priced based on a documentation of TSLRIC costs as a price floor for the service, which U S WEST submits is the proper use of TSLRIC or TELRIC. Because the service is purchased primarily out of the interstate tariffs, over 75% of the revenues flow to the interstate jurisdiction. However, because of the way frame-relay service is separated, much of the investment and expense of providing this interstate service flows to the intrastate jurisdiction. The result is that U S WEST's interstate frame-relay service had 75% of the revenues but only 17% of the costs, with the result that U S WEST's interstate service showed a huge but false profit, while U S WEST's intrastate earnings were artificially depressed.

This particular case is dramatic in its illustration that separations and economic pricing of access are simply not compatible. However, the problem is by no means unique,[20] and these kinds of mismatches will exist as long as separations exist. The Commission is clearly correct that separations reform is necessary -- and immediately necessary. We submit that the Commission may be understating the extent to which the artificial separations process undermines the Commission's pro-competitive objectives. Indeed we submit that proper study will demonstrate that separations itself is so outmoded that the entire process should be eliminated altogether.

5. Competitive Depreciation Rates Are Vital

An especially pernicious type of implicit subsidy in the emerging competitive marketplace will occur if regulators at all levels do not undertake the vital task of rationalizing the depreciation lives of ILECs so that they have a reasonable opportunity to recover this investment in a timely manner and the proper economic incentive to invest in new plant and modernize existing plant. The proper life of plant for depreciation purposes must fully reflect the technological and competitive realities of the marketplace. It must recognize the fact that, in this marketplace, companies must introduce new technologies when the market calls for it -- even though, in a purely utilitarian sense, the existing plant may still be useful. The use of such economic depreciation lives in technologically dynamic industries is common and, indeed, vital. Despite the critical need for economic lives, using longer lives,

[20] Separation of the 800 database creates a similar mismatch.

which fail to recognize today's economic realities can appear attractive to regulators, because the use of overly long lives have the effect of artificially reducing depreciation expense and misstating actual profitability. Thus artificially long depreciation lives permit regulators to reduce rates.

The table below compares the range of Commission prescribed lives for U S WEST's major asset categories with the economic lives which are appropriate for us in a forward-looking cost study:

Depreciation Lives

CATEGORY	PRESCRIBED	ECONOMIC
Digital ESS	14.5 - 17.0	10
Digital Circuit	11.0 - 12.0	10
Analog Circuit	8.0	7
Aerial Cable - Copper	18.0 - 24.0	11.3
Underground Cable - Copper	25.0 - 27.0	11.3
Buried Cable - Copper	20.0 - 27.0	15
Fiber	25.0 - 30.0	20

The economic lives are very much inline with those used by competitors for the same types of assets in many cases purchased from the same vendor. For example, AT&T uses a 9.7 year life for digital switching, a 7.2 year life for digital circuit equipment and a 20-year life for fiber accounts. It is a fundamental principal of economics that U S WEST be allowed to use comparable depreciation lives as those used by competitors. To not allow U S WEST to use economic depreciation lives places it at a distinct competitive disadvantage relative to current and potential competitors.